United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

74-1750

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P/S

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 74-1750 and 74-1831

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee

-against-

NORTH AMERICAN RESEARCH AND DEVELOPMENT CORP., ET AL.,

Defendants,

NORTH AMERICAN RESEARCH AND DEVELOPMENT CORP., EDWARD WHITE AND ALFRED BLUMBERG,

Defendants-Appellants.

On Appeal from the United States District Court for the Southern District of New York

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BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION APPELLEE

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BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION, APPELLEE

COUNTERSTATEMENT OF THE ISSUES PRESENTED

1. When evidence which would be admissible at the trial for permanent relief has been adduced at a lengthy hearing for preliminary injunction in which the defendants fully participated; when the defendants had notice long in advance of the trial that this evidence would be considered as part of the record; and when, at the trial, the defendants had an opportunity to recall and cross-examine witnesses, to make specific objection to the court's consideration of documentary evidence and otherwise to defend against the allegations of the complaint, may these defendants nevertheless require that

there be a complete de novo proceeding against them before permanent relief may be granted.

2. When defendants have fraudulently sold unregistered securities of a particular company, is it an abuse of discretion for a district court to enter a broad injunction against (1) the defendant basically responsible for the entire fraudulent scheme, who participated in the preparation of false and misleading sales literature, who admits having prepared similar literature for a number of other companies, and sees nothing wrong in what he has done, and who presently participates in the management of several publicly owned or privately owned corporations; and (2) another defendant, long active in the securities business, who promoted the sale of securities to numerous investors, although he knew virtually nothing about the issuer, who distributed false and misleading sales literature, and who exercised discretionary authority to purchase the security for the accounts of others.

COUNTERSTATEMENT OF THE CASE

THE PROCEEDINGS TO DATE

In this action the Commission sought permanent injunctions against 43 defendants alleged to have violated the registration requirements of the Securities Act of 1933 [1/] and antifraud provisions of both that Act [2/] and the Securities Exchange Act of 1934, [3/] in connection with the offer and sale of securities issued by North American Research and Development Corporation.

1/ Sections 5(a) and 5(c), 15 U.S.C. 77e(a) and 77e(c).

2/ Section 17(a), 15 U.S.C. 77q(a).

3/ Section 10(b), 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 CFR 240.10b-5.

In the course of the proceedings, permanent injunctions were entered against twenty-one of the defendants by consent[4/] and against thirteen others by default;[5/] the action was discontinued as to three peripheral participants who executed undertakings to comply with the registration and antifraud provisions of the securities laws;[6/] and the complaint was dismissed as to one defendant.[7/] One person named as a defendant in the complaint was never served.[8/] Consequently, at the time of trial before the district court only four of the original defendants remained: North American Research and Development Corporation, the unregistered securities of which were the subject of the fraudulent sales alleged in the complaint; Edward White, the chief executive officer of North American, who was alleged to have conceived the fraudulent scheme and to have been the driving force behind it; K. Ralph Bowman, the secretary-treasurer of North American; and Alfred Blumberg, who was alleged to have solicited purchases of North American shares, to have distributed to prospective purchasers copies of a misleading "progress report" issued by North American and to have bought North American shares for the accounts of others.

4/ Consent judgments of permanent injunction were entered against the following defendants: Howard Alweil; Bateman Eichler, Hill Richards, Inc.; Ramon N. Bowman; James Cheatham; Lewis Dillman; Dunhill Securities; Donald Glenn; Philip R. Gould; Gould's Position, Inc.; Lars Hagglof & Co., Ltd.; Wellington Hunter, d/b/a Wellington Hunter Associates; Robert Johnson; Griffith C. Lindquist, d/b/a Lindquist Securities Co.; Martin Orenzoff; Rex Reno; Roberts, Scott & Co., Inc.; Sidney Rosen; Charles Snodgrass; Guido Volante; Frank Whitney and Richard Whitney.

5/ Default judgments of permanent injunction were entered against the following defendants: Robert Axmith; Morris M. Cooper; Diversified Management Corp., Ltd.; Bella Freedman; Lillian Freeman; Sam Freeman; Eleanor Joseph; Frank Naft; Esther Oventhal; Francis Oventhal; Margaret Raphael; Sonia Starr and Corinne White, also known as Corinne Naft.

6/ Norma Bowman, Albert Conrad and Abby Whitney.

7/ Redroof Trading Co., Ltd. after the death of its principal officer.

8/ Gail Dombrofsky, a Canadian citizen.

Trial was held before District Judge Edward Weinfeld on June 27, 1973. Pursuant to Rule 65(a)(2) of the Federal Rules of Civil Procedure, the Commission relied substantially upon the admissible evidence that had been adduced from twenty-four witnesses in the course of a seven-day hearing that had been held before then District Judge Walter R. Mansfield when the Commission sought preliminary relief against the defendants in 1968 (T 6-7) 9/ (Pr. 1-1136). 10/ The Commission also relied (T 14-15) upon the summary judgment that Judge Constance Baker Motley had entered against North American on September 29, 1972, holding that the corporation had violated the registration and antifraud provisions as alleged, but leaving open for trial the question whether or to what extent North American should be enjoined (59 F.R.D. 111, 115). 11/ In addition, the Commission called defendants White and Blumberg to testify (T 27, 55).

9/ "T__" refers to the transcript of the trial on the merits before Judge Weinfeld. "Pr.__" refers to the transcript of the preliminary hearing. "__a" refers to the joint appendix filed by the parties. By stipulation, the parties will also rely on the appendix and supplement appendix provided for the prior appeal in this case (Nos. 32246 and 33817). The earlier appendix will be cited "__aa" to distinguish it from the current volume, the supplemental appendix will be cited "__b". The brief in this appeal by North American and White is cited "NARD Br. __." Appellant Blumberg's brief is cited "Bl. Br.__."

10/ Judge Mansfield's decision on the Commission's motion for a preliminary injunction is reported at 280 F. Supp. 106. On appeal, this Court, 424 F. 2d 63 affirmed so much of Judge Mansfield's decision as had granted preliminary relief against 14 defendants, including appellant North American and appellants White and Bowman, and reversed so much of his decision as had denied preliminary relief against four defendants, including Mr. Blumberg.

11/ Summary judgment on the question of violation had also been entered against defendant K. Ralph Bowman by Judge Motley. At the trial, counsel represented that Mr. Bowman would consent to an injunction (T 14); when he had not done so voluntarily, however, a permanent injunction was entered against him on the basis of Judge Weinfeld's findings, 375 F. Supp. 474. Mr. Bowman has not appealed.

At the trial the defendants called no witnesses and offered no additional testimony (T 105).

Thereafter, based "[u]pon the entire record" 375 F. Supp. at 465, 467, Judge Weinfeld issued an opinion on March 8, 1974, holding that Edward White and Alfred Blumberg had violated the registration requirements and antifraud provisions of the securities laws as the Commission had claimed. For reasons set forth in his opinion, Judge Weinfeld concluded that these defendants and defendant North American should be permanently enjoined from further violations of the registration and antifraud provisions of the securities laws in connection with the offer and sale of North American securities or any other securities. An order to that effect was signed by Judge Weinfeld on March 25, 1974, and was entered on March 26, 1974. Defendants North American, White and Blumberg appeal from that order.

COUNTERSTATEMENT OF FACTS

Summary

In the opinion upon which the order under review was entered (375 (7a-40a), the district court found Edward White to have been the "central figure, if not the master mind" of a scheme by which, within a three-month period, he and others (1) acquired control of Utah Fortuna Gold Company, an inactive publicly-held corporation without assets, (2) took steps to give it the outward appearance of great potential development (while changing its name to North American Research and

Development Corporation) and (3) promoted and made a public distribution of a portion of its stock.

As set forth more fully below, White, on April 27, 1967, acquired for himself and a nominee 1,000,000 shares of the company's approximately 1,800,000 shares at a cost of one cent per share. Within a few days before and after this acquisition by White, other defendants were acquiring most of the remaining shares from minority stockholders for a penny or less per share. White's 1,000,000 shares had been part of a block of approximately 1,200,000 shares owned by South Utah Mines, Inc., for which that corporation was paid $500; the 200,000 additional shares were turned over to two other defendants as finders' fees. These 200,000 shares, together with 553,000 shares purchased from minority shareholders, were transferred to accounts maintained in Toronto, Canada, in the names of relatives and friends of White or of persons who were found by the district court to have been White's principal co-conspirators, Sam Freeman and Frank M. Naft.

At the same time, White and others urged various brokers in the United States to buy the stock when it should become available. As a result of these efforts, 197,000 shares from these Toronto accounts were sold to investors in the United States between June 27 and July 20, 1967. In accordance with White's prediction to the brokers, the stock began selling over-the-counter in the United States at about $2.00 on June 27. In the period to July 20, 1967, the over-the-counter market

price of the stock in the United States, as the court noted, "was run up . . . from 1/2 cent per share over-the-counter . . .," which the original minority shareholders had been paid, ". . . to more then $6.00 per share" (11a, quoting Mansfield, Jr., 280 F. Supp. at 112). On July 20, before any further sales were made into his country from Toronto and before White or his nominee had disposed of any of their 1,000,000 shares, except for 350,000 they had transferred to the defendant Bowman for the assets of a corporation held by the latter, the Commission suspended trading in the stock. The suspension was lifted after preliminary injunctions were entered against the principal participants in the scheme by the district court. See Securities Exchange Act Release Nos. 8130 and 8276. 32 Fed. Reg. 11000 (1967); 33 Fed. Reg. 5184 (1968).

Acquisition of Control by White

In March 1967, White let it be known among his friends that he wished to control a corporate shell (479aa). Sam Freeman, a Toronto stockbroker who had been White's friend for some fifteen or twenty years (479aa), located the Utah Fortuna Gold Company through the efforts of K. Ralph Bowman of Salt Lake City, Utah. All but approximately 600,000 shares of the 1,800,000 shares of this inactive company, which White admitted was "virtually worthless" (530aa, 273-274aa), were held by South Utah Mines. Bowman, through Richard Whitney (a friend and associate) and Donald Glenn (Whitney's friend)[12/], was put in touch with

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12/ Unless otherwise specified, references to "Whitney" are to Richard Whitney and not to his brother Frank Whitney, who was also a defendant.

Robert A. Johnson (224-227aa; 231-240aa), who was then an officer and director of both companies, as well as the transfer agent of Utah Fortuna Gold Company (263-267aa; 292aa). Johnson was found by Judge Weinfeld to have "exercised the 'managerial and financial decisions' of Mrs. Mabel McGarry, who was the owner of approximately 75% of South Utah Mines." (18a). Having learned of the prospective purchaser for what otherwise appeared to be a worthless shell, Johnson in the latter part of March 1967, obtained Mrs. McGarry's authority to sell the 1,200,000 Utah Fortuna Gold Company shares held by South Utah Mines (290-292aa). Johnson then agreed to sell the control stock to Whitney, and through him to those whom Whitney represented;[13/] on April 27, the sale to Whitney was effected (294aa).[14/] Whitney immediately resold 1,000,000 shares to White and his nominee, Sonia Starr (153-157aa; 249aa; 170-172b).

Acquisition of Publicly-Distributed Shares

Freeman had told Bowman that if he were able to acquire any additional shares (beyond those to be acquired by White) they would be purchased by the Toronto brokerage firm of J. P. Cannon & Co. ("Cannon") and Lars Hagglof & Co., Ltd., ("Hagglof") (241-242aa); and White provided

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13/ On April 20, 1967, Johnson's offer to Whitney was reduced to writing in the form of a ten-day option reciting Whitney's right to purchase 1,202,000 shares (291aa; 168b). On April 26, 1967, the three-member board of directors of South Utah Mines, which included Johnson and Mrs. McGarry, formally ratified the agreed terms of sale (169b).

14/ Of the $10,000 paid by White, Johnson retained $1,000, Bowman was paid $3,875, Whitney received $2,500, and Mrs. McGarry, individually received $500. After additional amounts were paid to others, South Utah Mines, the seller, netted only $500 (137aa; 147aa; 295aa).

the names of the same two firms to Whitney (163-164aa).[15/] At the time that White acquired 1,000,000 of the Utah Fortuna Gold Company shares, Johnson, by prearrangement with Bowman and Whitney, transferred 100,000 shares to Glenn and 100,000 shares to Whitney's brother as finders fees (176-177aa, 228-229aa). They, in turn, promptly sold the shares to Cannon in Toronto (45b, 56b).

While the sale of control to White was still being arranged, Bowman and Whitney jointly undertook to acquire most of the remaining Utah Fortuna Gold Company shares (162-175aa, 242-252aa). For that purpose they requested and obtained Johnson's aid; he reviewed the stockholders' lists with them, solicited sales from stockholders that he knew, and permitted Bowman and Whitney to use the lists to identify and locate other prospective sellers (172-175aa; 178aa; 241aa, 277-279aa). By about June 5, 1967, Bowman, Whitney and Johnson had obtained and sold to Cannon and to Lars Hagglof & Co., Ltd., some 553,000 shares (173aa, 183aa, 280aa). All told, as a result of these various efforts, as Judge Weinfeld found:

> "By June 27, 1967, approximately 96.8% of the 1.8 million shares of the company outstanding was under control of the White-Freeman-Naft trio, including the one million shares held by White and his nominee Sonia Starr, and 753,000 shares acquired through Cannon and Hagglof held in the names of close friends and relatives of the trio. The methods and means of

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15/ J. P. Cannon & Co. purchased shares offered from Salt Lake City for the accounts of the wives of Freeman and Naft and Freeman's mother-in-law (45b-52b). Subsequent instructions provided for purchases in the names of friends and other relatives of Freeman and Naft.

> acquisition and the relationship between the White-Freeman-Naft trio and the parties in whose names the stock was held in Toronto indicate that the 753,000 shares were acquired in Toronto with a view to the distribution of all or a very substantial portion of it in the United States."

(19a-20a).

Promotion and Distribution

Once the program of acquisition was well under way, White and his associates took steps to make possible a successful redistribution of the shares in the United States. His original plan had been simply to transfer some Canadian mining claims to the corporation (482-495aa) and then to promote trading in the company's stock (488aa). While White was in Salt Lake City to effect his purchase of the majority of Utah Fortuna Gold Company's outstanding stock, however, a new and more attractive basis for promotion presented itself.

The Storrs Process

K. Ralph Bowman, who, as noted above, had a pivotal role in the acquisition of shares from former stockholders, was the president and controlling stockholder of Thermal Dynamics Corporation; Richard Whitney, his partner in the acquisitions, was its secretary (128aa). That corporation owned rights to a method by which it was hoped that pollution-free coke might be produced commercially, called the Storrs Process, and also owned a pilot plant that had been built to test the process (443-444aa). White decided to use the Storrs Process as the basis for promoting the sale of Utah Fortuna Gold Company stock. Accordingly, on May 19, 1967, Utah Fortuna Gold Company acquired all the assets of Thermal Dynamics Corporation, including the patent application pertaining to the process (443aa).

The planned promotional emphasis having been shifted from speculative mining claims to the unproved process, the corporate name was changed to North American Research and Development Corporation at a June 19, 1967 stockholders' meeting, at which White voted proxies from 1,500,000 of the total of 1,800,000 million shares outstanding (388-392aa, 204-205b). At the same time White was elected chairman of North American's board of directors; Lewis Dillman, a Canadian friend of White's, became its president, and Bowman was elected secretary-treasurer (204-205b).

The "Progress Report" (206-216b)

White and Dillman, with a professional writer not named as a defendant (515-516aa), then prepared a "sales brochure in the form of a 'Progress Report'" (22a, 206-216b) pertaining to North American, which the district court held

> "was intended as, and in fact was, one of the principal means used to effect distribution into the United States of approximately 200,000 shares held in [the] Toronto accounts."

375 F. Supp. at 470.

Although White estimated the number of minority shareholders prior to his acquisition at about 80 (485aa), and their numbers were necessarily reduced by the time that White, Freeman and Naft had acquired control of 96.8% of the outstanding shares, 1,000 copies of the report were printed and between 200 and 250 were distributed (526-527aa). The bulk of the copies were distributed by White (583aa) or Bowman (515aa, 529aa) to stock brokers and other prospective purchasers.

As Judge Weinfeld observed, the progress report

> ". . . painted a glowing picture of a pollution-free fuel market in which the Storrs Process would play a leading part. . . . The report conveyed the impression, contrary to fact, that North American had the production capacity and the financial resources to satisfy current as well as potential market demands and to carry out an extensive program of expansion of processing plants in or near coal mining centers."

(23-24a). Notwithstanding the implication of financial strength and stability, however, the defendants had no financial information available at the time when the Storrs Process and the pilot plant were acquired (524aa), and at the time the progress report was prepared no financial information was expected for about 60 days (528aa). When an accountant's report was later received, it contained a severely-qualified opinion which noted that the major asset values reflected were not "presently determinable" (DX E, p. 2).[15a/]

The "impression that the plant was currently in operation in July 1967," when the report was disseminated, was misleadingly conveyed by the report's explicit reference to a "fully equipped operating pilot plant . . ." (210b) (emphasis added), as well as by the photographs provided by Bowman for use in the report (446aa), which showed men working at machinery (213b). In fact, the pilot plant had not been operated for some time (446aa) and the economic practicality of reopening the plant required further study (444aa, 447aa).

The report also suggested that the commercial feasibility of the Storrs process had virtually been proven. It referred to earlier "feasibility studies" which "indicated that a profitable operation can be

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15a/ "DX___" refers to Defendant's Exhibits.

anticipated," and suggested that future tests would merely "verify the commercial value" of the process (213b). Thus, as the district court observed, the report "conveyed the impression of a profitable operation with verification being in the nature of a pro forma review" (25a). To the contrary, as White testified, the very first problem to be faced was the question of feasibility itself (519aa). And the defendants' own witness, Charles S. Davis, a consulting engineer, testified that a feasibility study, which the plant would be capable of carrying out only after $30,000 was spent to put it "back into first-class operating condition" (427aa), would take from 30 to 60 days (430aa). Indeed, only the self-serving testimony by Bowman, who recognized that expert opinion was to the contrary (446aa, 453-454aa), suggested that feasibility had already been shown (44-445aa, 454aa).

The scope of North American's prospective activities was also misleadingly represented by the claim that it was "envisaged that processing plants could be . . . either directly owned by your Company, or by others under a lease or royalty agreement." (210b). White himself testified that as these words were written "there was no . . . plan to build any plant" (519aa), and no intention that North American would own any of these operations (528aa). Furthermore, it had originally cost 450,000 merely to construct a pilot plant (454aa); North American at the time the Progress Report was disseminated had less than $50,000 available, of which $30,000 would be required to put the pilot plant into operation (DX E, p. 3; 427aa, 461aa).

Judge Weinfeld concluded that the "Progress Report was materially false and misleading." (22a).

Individual Promotional Efforts of Certain Defendants

Meanwhile, White, Freeman and Naft had begun promoting the stock to broker-dealers in the United States with a view toward its introduction in the over-the-counter market at the end of June 1967. For example, White and Freeman flew to Los Angeles after the June 19 Stockholders' meeting and, "with no financial data or other detailed information available, resorted," as the court said, "to touting tactics" (26a) for the benefit of officers and registered representatives of at least two brokerage firms, Bache & Co. (393-397aa) and Bateman Eichler, Hill Richards, Inc. (404-422aa). They gave the impression that they believed that the company had great prospects. To dramatize the Storrs Process and their purported estimates of the large potential market for anti-pollution coke they displayed a sample of coke (393aa, 417aa), the clear implication being that it had been successfully produced at the pilot plant, although the plant had not operated since 1964 (446aa). They advised that trading in the shares from the Cannon firm in Toronto would commence in the Los Angeles market on about the 26th or 27th of June "around the $3 range or below" (407aa),[16/] and early in July they made available

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16/ One witness testified that she had been present at private conversations between White and Freeman during that Los Angeles visit, and that when Freeman suggested that they might get the price of the stock up to $100, White countered that they "were going to take it slowly up to 10. That it couldn't move too fast because it was bad for a stock to move too fast" (138b), and that White had stated "if it went up to 100 that the SEC would be down there" (139b).

copies of the Progress Report (396aa, 409aa). White also admittedly discussed North American with at least two more brokers (513-514aa 539-540aa) and actually placed orders for North American stock for at least two persons (385-387aa).

The aid of others was also enlisted in the scheme of distribution. Appellant Alfred Blumberg was found to have:

> "solicited the purchase of North American shares and distributed the Progress Report and thereby caused purchases of unregistered shares; he played an active and knowing role in aiding and abetting the principals in the distribution of unregistered stock."

(28a).

After Blumberg had visited Toronto and had received promotional information from White (340aa), he touted North American as a good buy that could increase in value and by his own admission (Bl. Br. 4-5) furnished copies of the Progress Report to prospective buyers in the New York area. Blumberg's own testimony reveals that he intended to make his living through commissions and was interested in retaining his customers until he could become established (Pr. 492). In addition to shares that he purchased for three discretionary accounts (89-91b) and those bought for his mother at his discretion, no less than fifteen other investors to whom he had advocated purchase of North American shares and had "recommended that they use the services of Dunhill Securities" (95b), a New York broker-dealer, had placed orders for North American stock with Dunhill. (89-94b with JX 26).[17/]

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17 / One witness, who described the sales pitch by which Blumberg induced his purchase of 500 shares, testified that he asked Blumberg to buy the shares for him and that Blumberg had done so (146-148b).

17a/ "JX" refers to the exhibits of affiant Edward Jaegerman.

representations made to them by Blumberg. Murry Cousins, who bought 300 shares (Pr. 641), testified that Mr. Blumberg represented himself as a member of the group promoting North American stock, and that he was in the brokerage business (Pr. 646); Solomon Schneider, who purchased 300 shares (Pr. 678), described statements made by Blumberg concerning a contract that he said North American would have with the General Electric Company (Pr. 682); and Joseph Corby, who purchased 500 shares on Blumberg's recommendation (142b), testified that Blumberg had referred to the Pilot Plant, described the Storrs' process as proven, and alluded to pending contracts with utility companies (142-145b). In addition, the record strongly suggests that Blumberg was instrumental in linking Dunhill with its Canadian sources of supply of North American securities. 18/

18/ It was through defendant Cooper, a friend of Blumberg's, that Blumberg met with White and first learned of the North American promotion (332-337aa). Most of the North American Stock distributed by Dunhill was sold by Gail Dombrofsky, Cooper's sister, and Frances Oventhal, his mother-in-law (96-98b). The registered representative who received the commission on the sales made by Cooper's relatives had known Blumberg for some 15 years (98b). Blumberg himself admitted that he "might have" been responsible for the link between Dunhill and the Canadians, although not in the very direct sense that the evidence otherwise indicates (99b).

ARGUMENT

I. APPELLANTS HAVE HAD A FAIR TRIAL.

As we have seen in the foregoing Counterstatement of Facts, all material findings made by Judge Weinfeld are fully supported either through the testimony of live witnesses or by documentary evidence the authenticity of which has not been disputed. Thus, appellants North American and White do not contend that the facts found by Judge Weinfeld are clearly erroneous;[19/] nor do they dispute that these facts, as Judge Weinfeld held, are adequate to demonstrate that they violated the Securities Act and the Securities Exchange Act, as Judge Weinfeld found. Similarly, while appellant Blumberg would have this Court accept his version of certain events in lieu of the findings made by Judge Weinfeld (Bl. Br. p. 6), he does not deny that the facts found by Judge Weinfeld are consistent with testimony the record contains or that these facts, once accepted, demonstrate Mr. Blumberg's complicity in the fraudulent sale of unregistered securities. Instead, the appellants claim to have been denied a fair trial.

In effect, appellants attack the validity of that portion of Rule 65(a)(2) of the Federal Rules of Civil Procedure which

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19/ Rule 52(a) of the Federal Rules of Civil Procedure provides, in pertinent part: "In all actions tried upon the facts without a jury . . . [f]indings of fact shall not be set aside unless clearly erroneous." The appellate court must be ". . . left with the definite and firm conviction that a mistake has been committed." United States v. United States Gypsum, 333 U.S. 364, 395 (1948); Heyman v. A. R. Winarick, Inc., 325 F. 2d 584 (C.A. 2, 1963).

provides that

> ". . . any evidence received upon an application for a preliminary injunction which would be admissible upon the trial on the merits becomes part of the record on the trial and need not be repeated upon the trial."

Consistent with this rule, Judge Weinfeld considered the admissible evidence that had earlier been adduced at the preliminary injunction hearing to be a "part of the record on the trial," and based his decision on that evidence. This Court has previously given its implicit approval to the utilization of this procedure, Securities and Exchange Commission v. Manor Nursing Centers, Inc., 458 F. 2d 1082, 1088-1089, n.2 (C.A. 2, 1972).

Of course, the right to a trial involves a fair opportunity to confront and cross-examine material adverse witnesses, to respond to the evidence adduced or make proper objection to its consideration and otherwise to defend against charges made. But due process deals with matters of substance and is "not to be trivialized by formal objections that have no substantial bearing on the ultimate rights of parties." See Market Street Ry. v. Railroad Commission, 324 U.S. 548, 562 (1945). Accordingly, the use at trial of testimony earlier recorded either in the same proceeding or in another proceeding has often been permitted so long as fundamental fairness is observed. See, e.g., Walker v. Loop Fish & Oyster Co., 211 F. 2d 777, 780 (C.A. 5, 1954). For example, depositions taken in one case may

be admitted in evidence on the trial of an entirely new action for use "against any party who was present or represented at the taking of the deposition or had due notice thereof." See, e.g., Insul-Wool Insulation Corp. v. Home Insulators, Inc., 176 F.2d 502, 504 (C.A.10, 1949); Hertz v. Graham, 23 F.R.D. 17 (S.D.N.Y., 1958), reversed in part on other grounds, 292 F.2d 443 (C.A.2), certiorari denied, 368 U.S. 929 (1961). In fact, it has been held that a deposition may be introduced as evidence against a person who had no opportunity to be present when it was taken, so long as "an adversary with the same motive to cross-examine the deponent" had been present, and there is an "identity of issues in the case in which the deposition was taken with the one in which it is sought to be used. " Ikerd v. Lapworth, 435 F.2d 197 (C.A.7, 1970). It follows that where testimony has been given at an earlier stage in the very same proceeding directed toward the very same issues, and the parties against whom the evidence is to be used had an opportunity for cross-examination at that time, there is no reasonable basis upon which that evidence Indeed, this Court has recognized that a plaintiff's case may be presented entirely by deposition, if the plaintiff is willing to risk the advantage this may give the defendants, who will be able to respond with live testimony. Richmond v. Brooks, 227 F. 2d 490 (C.A. 2, 1955).

With respect to the right to trial and to cross-examine adverse witnesses,

> "What the Constitution . . . require[s] is 'an opportunity * * * granted at a meaningful time and in a meaningful manner." Armstrong v. Manzo, 380 U.S. 545 . . . (1965) (emphasis added) . . . ."

Boddie v. Connecticut, 401. U.S. 371, 378 (1971). Accordingly, even if, contrary to the actual facts, the appellants at bar had not had an opportunity for cross-examination when the testimony had originally been given, it would nevertheless have been consistent with the concept of fundamental fairness, and thus due process, for the testimony to have been relied upon by Judge Weinfeld so long as the appellants had been afforded an opportunity for cross-examination at the time of the trial prior to entry of the final judgment. Cf., Nees v. Securities and Exchange Commission, 414 F. 2d 211 (C.A. 9, 1969); Hansen v. Securities and Exchange Commission, 396 F. 2d 694 (C.A. D.C.), certiorari denied, 393 U.S. 847 (1968). Here, in addition to the earlier opportunity for cross-examination, an opportunity was indisputably given at the trial to recall witnesses for further cross-examination or to present a defense on the merits. That final opportunity is all due process required; appellants are not entitled to profit from their failure to have taken advantage of it.

In any event, the appellants do not show in what manner, if any, they were prejudiced by the use of the earlier testimony. One would assume, to the contrary, that the procedure followed was greatly to their advantage. By virtue of Rule 65(a)(2) itself, discussions held before Judge Mansfield concerning use at the trial of the evidence adduced before him at the preliminary hearing (see NARD Br. 18-19), the opinion of Judge Motley, noting that the original evidence could be relied upon at trial (July 14, 1972, at p. 10), and an explicit

ruling by Judge Weinfeld to that effect (Order dated May 7, 1973), appellants knew that the Commission would be entitled at trial to rely upon the admissible evidence adduced at the preliminary hearing and would do so. Accordingly, they could have planned their defense to respond to the evidence they knew the record to contain. See Carter-Wallace, Inc. v. Otte, 474 F. 2d 529, 537 (C.A. 2, 1972).

We have no disagreement with the cases emphasized by appellants White and North American (NARD Br. 11-13), which hold that a permanent injunction may not be entered against a party who has had no notice that permanent relief was being considered by the court and no opportunity to respond for that purpose to the evidence adduced.[20/] But that is not the case at bar. Even if it were true, as appellants claim, that they did not fully defend at the hearing on preliminary relief because they chose to "hold their fire until the trial" (NARD Br. 11; Bl. Br. 2),[21/]

20/ All of the cases relied upon emphasize that if notice is given only of a hearing for temporary or preliminary relief, adversely affected parties will have no adequate warning that they might be in jeopardy of a final disposition. Accordingly, it was held they they had not had a full and fair opportunity to present their case on the merits. See, Capital City Gas Co. v. Phillips Petroleum Co., 373 F. 2d 128 (C.A. 2, 1967); Pughsley v. 3750 Lake Shore Drive Cooperative Building, 463 F. 2d 1055 (C.A. 7, 1972); cf., Nationwide Amusements, Inc. v. Nattin, 452 F. 2d 651 (C.A. 4, 1971); see also Moore's Federal Practice, Section 65.04(4) (1974).

21/ The brief for appellants White and North American (p. 4) also states that counsel who represented them at the preliminary hearing assumed that the Commission would be able to establish a prima facie case, and, accordingly, "they felt no obligation to present their full, or their best, case." Again in the Summary of Argument the brief states (pp. 6-7) that it can be assumed that when appellants' motion for a consolidated hearing and trial under Rule 65 was

(continued)

unlike the cases they cite, the appellants here had due notice in advance of the trial that the court was going to consider the preliminary testimony as part of the record for permanent relief and were given an opportunity at the trial to respond to all of the Commission's evidence.

Nor do we dispute that when the Commission sought permanent relief it was required to sustain a heavier burden than when it sought and obtained preliminary injunctions (NARD Br. 11-14). It does not follow from this, however, as appellants appear to believe (NARD Br. 11, 14), that the evidence presented at the preliminary hearing was necessarily insufficient to meet the higher burden of proof required for permanent relief. At the trial the Commission was obliged to show by a preponderance of the evidence that the defendants had violated the securities laws as alleged in the complaint. The evidence of record points irresistibly to that conclusion; and the appellants' briefs are devoid of reference to any evidence contained in the record--other than Mr. Blumberg's self-serving assertions--that might support a contrary view.

We agree also that evidence may have been admitted at the preliminary hearing which might be deemed inadmissible in support of the Commission's prayer for permanent relief. But, as Judge Weinfeld understood and emphasized (see May 7, 1973, Order; 12a), only that portion of the evidence adduced at the preliminary hearing "which

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21/ (continued)
denied, "believing that a full trial would soon follow, the lawyer changed his strategy and tactics and decided not to put in his full, or best, case." These statements are inconsistent with the fact that these parties, with the same counsel, appealed to this Court from the preliminary injunction the Commission obtained against them.

would be admissible upon the trial on the merits becomes part of the record on the trial and need not be repeated . . . ." Rule 65(a)(2). Courts are competent to distinguish between admissible and inadmissible evidence, and on appeal it is presumed that the trial court relied only on proper evidence in reaching its conclusion, absent a clear showing to the contrary. United States v. 6.87 Acres of Land in the Village of Garden City, Nassau County, N.Y., 147 F. 2d 351 (C.A. 2, 1945). Thus it was recognized in Builders Steel Co. v. Commissioner of Internal Revenue, 179 F. 2d 377, 379 (C.A. 8, 1950);

> In the trial of a non-jury case, it is virtually impossible for a trial judge to commit reversible error by receiving incompetent evidence, whether objected to or not. An appellate court will not reverse a judgment in non-jury case because of the admission of incompetent evidence unless all of the competent evidence is insufficient to support the judgment or unless it affirmatively appears that the incompetent evidence induced the court to make an essential finding which would not otherwise have been made."

Apellants' vague references to inadmissible evidence certainly do not provide grounds for reversing the judgment below. This Court is not required to search the record for error. Continental Oil Co. v. United States, 184 F. 2d 802, 814 (C.A. 9, 1950). North Whittier Heights Citrus Assn. v. National Labor Relations Board, 109 F. 2d 76, 83 (C.A. 9), Certiorari denied 310 U.S. 632 (1940). As we have seen, supra pp. 7-16, the competent evidence contained in the record is more than adequate to support Judge Weinfeld's findings.

While appellant Blumberg asserts that the record before Judge Mansfield "contained testimony of witnesses that was either false, misleading, or otherwise inaccurate," and that "Judge Weinfeld ignored

the fact pattern," as testified to by Mr. Blumberg (Bl. Br. 1), Mr. Blumberg does not dispute the basic pattern of meetings and transactions from which Judge Weinfeld reasonably inferred Mr. Blumberg's complicity in the fraudulent scheme. Thus, Mr. Blumberg acknowledges having discussed North American with Mr. White in Toronto (28a, finding 19, with Bl. Br. 3); Mr. Blumberg does not "deny that . . . [he] had spoken to friends and associates in connection with matters dealing with North American" (29a, finding 20, with Bl. Br. 4); he admits that he received five copies of the Progress Report and passed three of them on to others (28a finding 18, with Bl. Br. 5); and he concedes that he purchased North American shares for the accounts of others (30a finding 21, with Bl. Br. 3).

Although Mr. Blumberg takes issue with the testimony of three witnesses upon whom Judge Weinfeld relied, Judge Weinfeld was not obliged to accept Mr. Blumberg's version of evidence in lieu of theirs -- particularly in light of Judge Weinfeld's adverse evaluation of Mr. Blumberg's credibility (13a). Nor does Mr. Blumberg explain on what legal basis this Court might hold Judge Weinfeld's findings, consistent with the testimony of these three witnesses, to be "clearly erroneous."

Mr. Blumberg suggests that these witnesses testified differently in an administrative proceeding conducted before the Commission from their testimony before the district court. While the relevant facts may have been explored at greater length in the testimony given in

the administrative proceeding than they were at the preliminary hearing in the case at bar, however, we are not aware of any material inconsistency nor does Mr. Blumberg cite any specific discrepancy.[22/]

Appellant Blumberg further contends that Judge Weinfeld did not have possession of the original exhibits that were introduced before Judge Mansfield at the preliminary hearing (Bl. Br. 1, 7; see also NARD Br. 28). But even if the original plaintiff's exhibits were not available to Judge Weinfeld, it does not follow that Judge Weinfeld did not have access to copies of all relevant exhibits when he reviewed the evidence in this case. To the contrary, Judge Weinfeld had access to the appendix and supplemental appendix that had been filed with this Court when cross appeals were taken from Judge Mansfield's order concerning preliminary relief.[23/] Only three of the Commission's exhibits were omitted from those appendices; these relate to the conduct of defendants who are not appellants before this Court, and are not to any extent necessary

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22/ The transcripts of the testimony of Joseph Corby and Murray Cousins in Matter of Wellington Hunter Associates, SEC File No. 3-1789, will be supplied to this Court upon request. Notwithstanding Mr. Blumberg's contention, it does not appear that Solomon Schneider testified before the Commission in an administrative proceeding.

23/ On April 12, 1974, Mr. Blumberg wrote to Judge Weinfeld, pointing out that the District Court record did not appear to contain the exhibits filed at the preliminary hearing before Judge Mansfield. In view of this fact he inquired how Judge Weinfeld based his decision on the entire record. In response, Judge Weinfeld noted in a letter dated April 19, 1974, that all relevant exhibits had been contained in the appendix and supplemental appendix filed in this Court on the cross appeals taken from Judge Mansfield's order of February 8, 1968. Although not a part of the record, Mr. Blumberg has submitted this correspondence to this Court as part of the appendix.

to support the findings of Judge Weinfeld.[24/] As to the remaining exhibits, appellant Blumberg does not suggest how he could have been prejudiced by the Judge's use of the copies in the appendices rather than the originals.

In any event, the Commission's case against appellant Blumberg rests primarily upon oral testimony (see pp. 14 through 16, supra). The only exhibit of significance with respect to Mr. Blumberg is the false and misleading Progress Report that he admits having distributed to three broker-dealer firms (Bl. Br. 5). Not only was a copy of the Progress Report contained in the supplemental appendix filed in the original appeal (pp. 2066-2166), but an additional copy appears to have been handed up to Judge Weinfeld at the trial (51a). If Mr. Blumberg believes that exhibits introduced by the defendants support his position, it was his duty, not the Commission's duty, to have brought those exhibits to Judge Weinfeld's attention.

II. THE ISSUANCE OF A BROAD INJUNCTION AGAINST THE APPELLANTS BY THE DISTRICT COURT WAS AN APPROPRIATE EXERCISE OF THE COURT'S DISCRETION.

The appellants each complain of the breadth of the injunctive decree against them; they suggest that it should be limited to their activities

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24/ Only Commission exhibits 8, 9 and 11 were omitted from the earlier appendices. Exhibits 8 and 9 relate to defendant Whitney's intent to purchase the Utah Fortuna corporate shell (197, 198aa). Mr. Whitney's intention, and his actual acquisition of the shell are shown by other evidence (479aa). Exhibit 11 is comprised of records of defendant Griffith C. Lindquist, a broker-dealer, showing which defendants had traded in the stock of Utah Fortuna through Mr. Lindquist's firm (178-179aa). The same facts are shown in Exhibit 18 to the affidavit of Edward Jaegerman, a questionnaire completed by Mr. Lindquist, which was reproduced at p. 45b of the Supplemental Appendix.

with respect to the securities of North American (NARD Br. 29; Bl. Br. 9). Having heard both appellants White and Blumberg testify, and having read the record, Judge Weinfeld concluded:

> "Permanent injunctive relief is essential to protect the public against these and other illegal acts and transactions of [the appellants] . . . with respect to the securities of North American or any other securities in the future." (39a).

Appellant White testified that he continues to believe that the shares of North American need not be registered (60a) and that the Progress Report, which three Judges of this Court and three Judges of the court below have now found to be false and misleading, [25/] is, nevertheless, a factually complete, accurate and truthful document (63a). In view of this testimony it is significant that Mr. White also testified that he has prepared similar reports for a number of other companies that he serves as an officer or director of several publicly-owned companies in addition to North American (52-58a); that he is president of several additional companies that at present are privately owned (T 67-68); and that Mr. White owns a substantial number of securities issued by other companies (58a).

25/ After Judge Mansfield entered a preliminary injunction based in part upon the materially false and misleading nature of the Progress Report, a panel of this Court (Medina, Moore and Feinberg JJ.) expressed agreement with those findings. Thereafter, Judge Motley found the Progress Report to be a fraudulent document and entered a preliminary judgment against defendants Bowen and appellant North American. Finally, after trial, Judge Weinfeld reached an identical conclusion. Any difference in the quantity or quality of proof that might be required of the Commission on the hearing for a permanent injunction from that on the preliminary injunction is not significant here, where the misrepresentations were in words and pictures contained in a printed document and the actual facts were essentially uncontroverted.

Based upon appellant Blumberg's testimony, Judge Weinfeld found that Mr. Blumberg had not troubled to examine the true facts about North American when he recommended that stock, distributed the Progress Report, and bought the stock for the account of others, and that in similar circumstances he would again act in the same manner. (34a) (65-66a).

In an action involving a remedial statute, the district judge has broad discretion to enjoin possible future violations where past violations have been shown, and his determination that the public interest requires the imposition of a restraint should not be disturbed on appeal unless it appears that there has been a clear abuse of that discretion. Securities and Exchange Commission v. Culpepper, 270 F. 2d 241, 250 (C.A. 2, 1959). The burden is on the party seeking to overturn the district judge's exercise of discretion, and the burden is necessarily a heavy one. Ordinarily, an appellate court will not substitute its views for those of the district judge unless it can be shown that there was no basis for the lower court's determination. United States v. W. T. Grant Co., 345 U.S. 629, 633 (1953).

As this Court stated in Securities and Exchange Commission v. Culpepper, supra, 270 F. 2d at 249 (emphasis added):

> "The critical question for the [district] court in cases such as this is whether there is a reasonable expectation that the defendants will thwart the policy of the Act by engaging in activities proscribed thereby."

It made clear, at pp. 249-250, that this is only a rephrasing of the test

set forth in United States v. W. T. Grant Co., 345 U.S. 629, 633 (1953) (emphasis added) that "the necessary determination is that there exists some cognizable danger of recurrent violation. . . ." And it is well settled that a "reasonable expectation" or "cognizable danger" of future violations, which will suffice to meet the statutory requirements, may be inferred from past violations alone, Securities and Exchange Commission v. Culpepper, supra, 270 F. 2d at 249-250; see Securities and Exchange Commission v. Boren, 283 F. 2d 312 (C.A. 2, 1960) (per curiam); Securities and Exchange Commission v. Okin, 139 F. 2d 87 (C.A. 2, 1943). Cf. United States v. Parke, Davis & Co., 362 U.S. 29, 47-49 (1960).

Furthermore, as the Court of Appeals for the Fifth Circuit observed in Securities and Exchange Commission v. MacElvain, 417 F. 2d 1134, 1137 (1969):

> "It has been held that in a suit for injunction, a defendant's assertion of the correctness of his behavior is a ground for restraint. Walling v. Helmerick & Payne, Inc., 323 U.S. 37, 43 (1944)."

Accord: Securities and Exchange Commission v. Manor Nursing Centers, Inc., 458 F. 2d 1082, 1101 (C.A. 2, 1972). This doctrine has particular application where, as here, the appellants profess to be unaware why what they did was wrong. Moreover, even if it were true that they do not understand their wrongdoing, as this Court recognized in Securities and Exchange Commission v. Texas Gulf Sulphur Co., 401 F. 2d 883, 860 (C.A. 2, 1968), the investing public may be injured no less when behavior proscribed by the Securities Exchange Act is negligently committed as when committed pursuant to deliberate plan. Accord: Heit v. Weitzen, 402 F. 2d 909, 193 (C.A. 2, 1968). Thus, this Court held in Securities and Exchange Commission v.

Culpepper, supra, 207 F. 2d at 249, that "the defendants' bona fide but mistaken misinterpretation of the law was no reason not to enjoin acts carried on at the time of suit." This Court there also observed, id. at 250:

> "In the formulation of its discretion . . . [the district court] should recognize that the public interest, when in conflict with private interest, is paramount. As was said in Hecht Co. v. Bowles, supra, 321 U.S. at page 331 . . .: The discretion of the courts 'must be exercised in light of the large objectives of the Act . . . .' Surely the Commission should not be required to keep these appellants under surveillance and to bring a subsequent injunction action if they commence again to sell 'tainted stock'." 26/

Application of these principles requires affirmance of Judge Weinfeld's judgment that the public interest required that the appellants be broadly enjoined from all violations similar to those they were found to have committed. As the Supreme Court noted in National Labor Relations Board v. Express Publishing Co., 312 U.S. 426, 435 (1941) a federal court has broad power

> ". . . to restrain acts which are of the same type or class as unlawful acts which the court has found to

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26/ These views are consistent with the views expressed in Securities and Exchange Commission v. Capital Gains Research Bureau, 375 U.S. 180, 200 (1963). There the Supreme Court noted, with respect to the Investment Advisers Act of 1940, that

> "to impose upon the Securities and Exchange Commission the burden of showing deliberate dishonesty as a condition precedent to protecting investors through the prophylaxis of disclosure would effectively nullify the protective purposes of the statute."

And in Securities and Exchange Commission v. W. J. Howey Co., 328 U.S. 293, 300 (1946) the Court stated:

> "[R]espondents' failure to abide by the statutory and administrative rules . . ., even though the failure result from a bona fide mistake as to the law, cannot be sanctioned under . . . [Securities Act of 1933]."

have been comitted or whose commission in the future, unless enjoined, may fairly be anticipated from the defendant's conduct in the past." 27/

CONCLUSION

For the foregoing reasons the judgment below should be affirmed.

Respectfully submitted,

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October 1974

27/ In McComb v. Jacksonville Paper Co., 336 U.S. 187 (1949), the Supreme Court considered an injunction which directed obedience to the provisions of the Fair Labor Standards Act dealing with minimum wages, overtime and the keeping of records. The Court observed:

"By its terms it enjoined any practices which were violations of those statutory provisions. Decrees of that generality are often necessary to prevent further violations where a proclivity for unlawful conduct has been shown."

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE
GENERAL COUNSEL

December 4, 1974

A. Daniel Fusaro, Esquire
Clerk, United States Court of
Appeals for the Second Circuit
United States Courthouse
New York, New York 10007

Re: Securities and Exchange Commission v. North American Research and Development Corp., et al, Nos. 74-1750 and 74-1831.

Dear Mr. Fusaro:

Enclosed are twenty five copies of the brief of the Securities and Exchange Commission, in final form with references to appendices, for filing in the above-captioned appeals.

I hereby certify that two copies of the Commission's brief have today been served by mail upon appellant Blumberg, pro se, and upon counsel for appellants White and North American Research and Development Corporation.

Very truly yours,

Richard O. Patterson

Richard O. Patterson
Attorney